SPEECH

The new energy shock: economic scenarios and policy implications

Keynote speech by Piero Cipollone, Member of the Executive Board of the ECB, at the 2026 Sustainable Development Festival

Milan, 6 May 2026

Thank you for the opportunity to speak at the Sustainable Development Festival.

Today, I will argue that the current energy crisis serves as a powerful reminder that Europe's path to robust and stable economic growth is only as viable as it is sustainable. We should care about sustainability not just, or even primarily, to protect the environment, but also because it is a key condition for our economic stability and prosperity. And in doing so, we Europeans can pursue our own specific interests, while also contributing to the common good.[1]

We are facing the second major energy shock in just four years. Following on from Russia's invasion of Ukraine in 2022, the war in Iran and the Middle East is now further hampering energy flows. And the closure of the Hormuz Strait is starting to disrupt global supply chains.

This shock has interrupted a positive, hard-won trend of stable prices and robust growth in the euro area over the last two years.[2] Inflation had returned to target. Real incomes had recovered from the previous energy shock, boosting consumption. Investment was on the rise. And domestic demand was more than making up for the decline in net exports stemming from higher US tariffs and the surge in imports from China. Overall, the European economy was showing strong resilience to the prevailing trade uncertainty.[3]

Now, this resilience is again being put to the test.

The war in Iran and the Middle East is already having an impact on prices and quantities. Oil and gas prices have surged, feeding into short-term inflation. And supply tensions have started to emerge, for instance in relation to jet fuels.

If sustained, the current shock could have significant implications for our medium-term inflation objective and the euro area's economic outlook.

So how can we best navigate this environment?

In the short term, we face considerable uncertainty over the evolving geopolitical situation. To support our decisions, we have developed economic scenarios, in line with the lessons learned from our experience in recent years.[4] As geopolitical developments and their implications unfold, these scenarios provide us with a benchmark to assess the situation in real time, informing our monetary policy decisions. We are paying

attention to possible signs of a de-anchoring of inflation expectations or of a break in economic dynamics, as we seek to ensure inflation returns to our target in a timely manner without unnecessary costs.

While monetary policy can ensure the return of inflation to target over the medium term and fiscal policy smoothen the hit to economic activity, there are inevitable trade-offs associated with the response to negative energy supply shocks, which must be carefully calibrated. Over a longer time horizon, however, the broader policy implications are clear. Geoeconomic shocks have major effects on prices and the economy. And our dependency on fossil fuels multiplies these effects. The current energy crisis thus underscores the pressing need to further reduce our reliance on fossil fuels not only because of climate risks but perhaps even more clearly because of energy security risks that are likely to be with us for some time.[5] Decarbonising will make us better off, not worse off.

In my remarks today, I will discuss the renewed energy shock and its short- and medium-term impact on inflation and the economy, before turning to the policy implications.

The energy shock and its short-term impact

Let me start by putting the current shock in perspective.

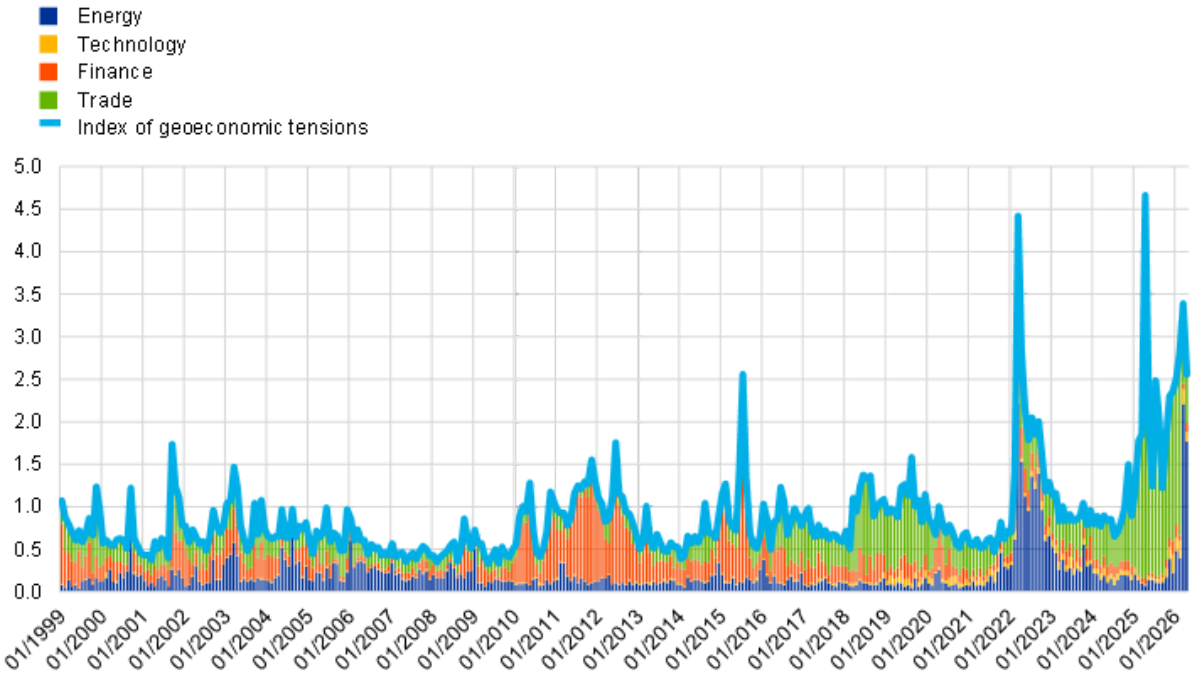
Geoeconomic tensions have spiked in recent years, reaching their highest levels since the launch of the euro (Chart 1). These disruptions to international economic relations, primarily affecting trade and energy, have arisen in a world that has never been as interconnected as it is today, thus magnifying their impact.

Chart 1

Index of geoeconomic tensions

Share of newspaper articles in France, Germany, Italy and Spain referring to geoeconomic tensions and decomposition by source of tension

(percentage)



Source: Ioannou, D., Prioriello, R. and Durrani, A. (forthcoming), “Measuring Geoeconomic Tension: A Large Language Model approach for the euro area”, ECB Working Paper Series. The index is available here in dashboard format.

Notes: The (L)arge-language-model (G)eoeconomic and Geo(P)olitical (T)ensions (LGPT) index for the euro area (main line) is constructed using two large language models (LLMs) on the basis of local language text (newspaper articles) in France, Germany, Italy and Spain. The index shows the number of newspaper articles discussing geoeconomic tensions as a share of the total number of articles. Geoeconomic tensions relate to the (potential or threat of) disruption to smooth international economic relations through the use of economic means such as trade or financial restrictions. The chart also shows the breakdown of the index into four sub-components based on the source of geoeconomic tension; namely, energy, trade, finance and technology. The latest observation is for April 2026. The cut-off date is 29 April 2026.

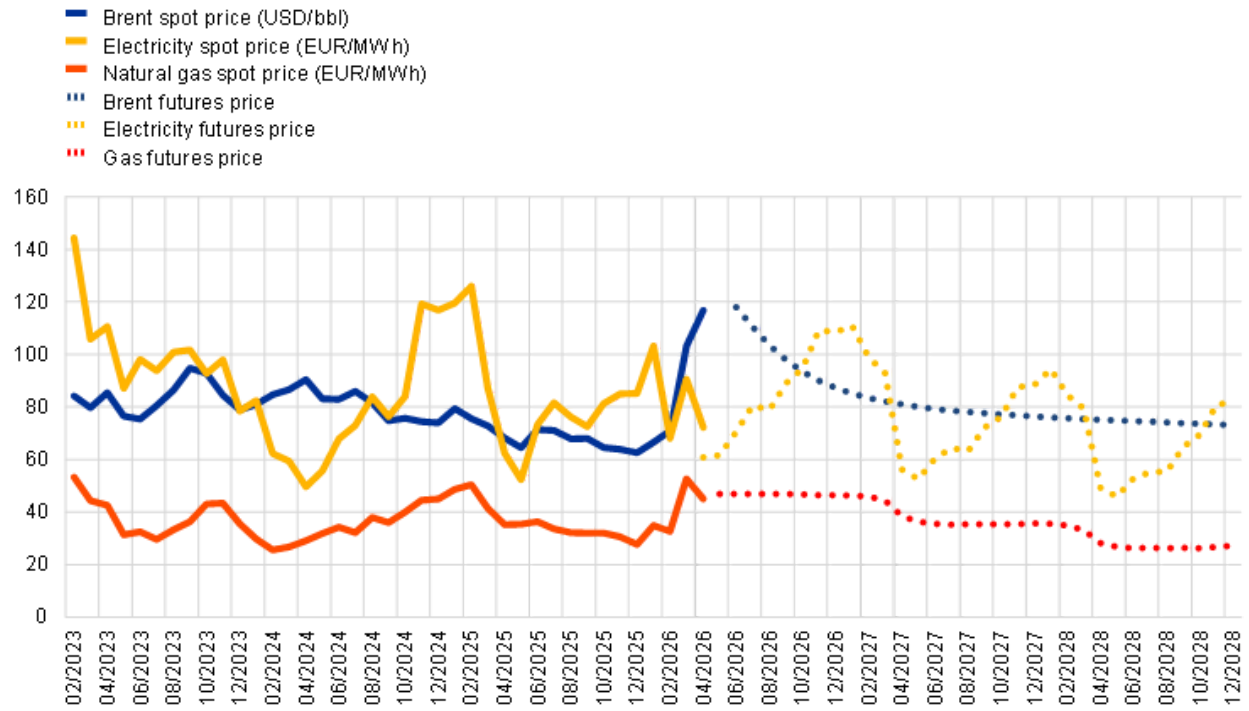
The short-term effect of the war in Iran and the Middle East on global oil supply is larger than in the three previous energy crises (1973, 1979 and 2022) combined.[6] Even after accounting for mitigating measures, such as the rerouting of oil flows through pipelines and the release of strategic reserves, the net decline in supply is estimated at around 12 million barrels per day,[7] representing about 11% of the prewar global oil supply. Restoring supply after the war will take time given the damage to major oil facilities. As a result, oil prices have surged (Chart 2).

Gas prices have also increased, but so far by much less than after Russia's 2022 invasion of Ukraine. This is important in the European context given how closely correlated electricity and gas prices are.

Chart 2

Oil, gas and electricity spot prices and futures

(USD/bbl. and EUR/MWh)



Sources: Eurostat and ECB calculations.

Notes: the latest observation is for April 2026.

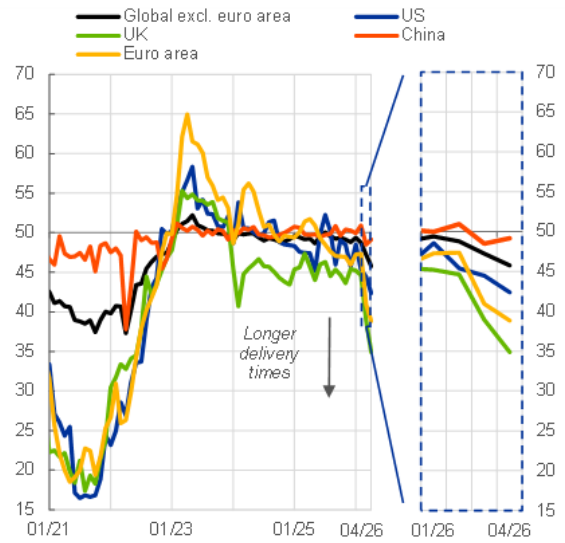
At the same time, the closure of the Strait of Hormuz has affected the trade of numerous critical commodities and chemical products, such as liquefied natural gas, refined oil products, aluminium, helium, sulphur and fertilisers. This constitutes a negative supply shock for the euro area economy, reducing the availability and pushing up the price of critical inputs. There is already some evidence of longer delivery times, rising input costs and supply shortages, albeit still contained compared with those seen between 2021 and 2022 (Chart 3).

Chart 3

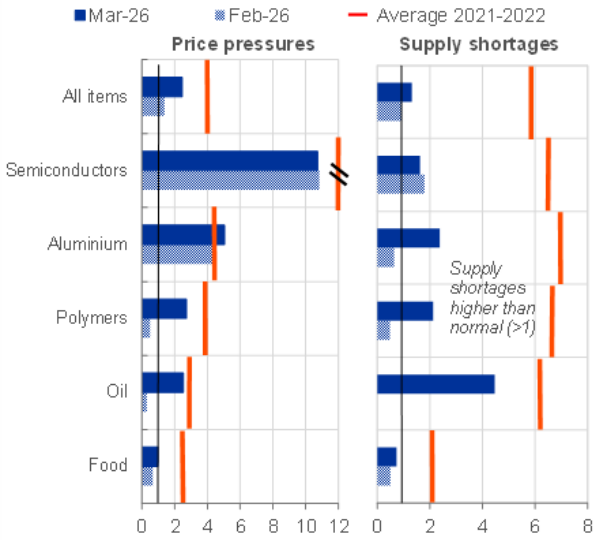
Delivery times and supply bottlenecks

a) PMI delivery times

(diffusion index)



b) PMI supply bottlenecks



Sources: HSBC/S&P Global/Haver Analytics and ECB staff calculations (panel a); S&P Global, Haver Analytics and ECB staff calculations (panel b).

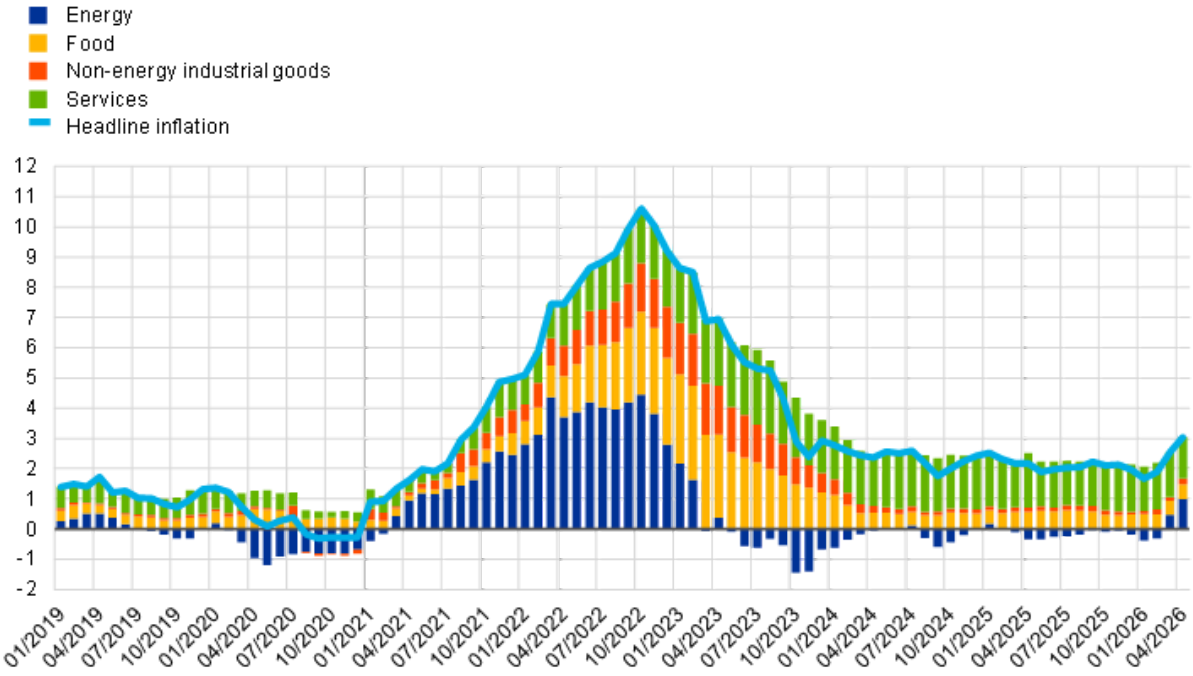
Notes: the latest observations are for April 2026 (panel a); the semiconductor price pressures average is 20.1 and the latest observations are for March 2026 (panel b).

The shock has pushed consumer prices higher. Annual headline inflation rose to 3% in April (Chart 4), driven by a 10.9% increase in energy prices, whereas inflation excluding energy fell to 2.2%.

Chart 4

Inflation in the euro area

(annual percentage changes and percentage point contributions)



Sources: Eurostat and ECB calculations.

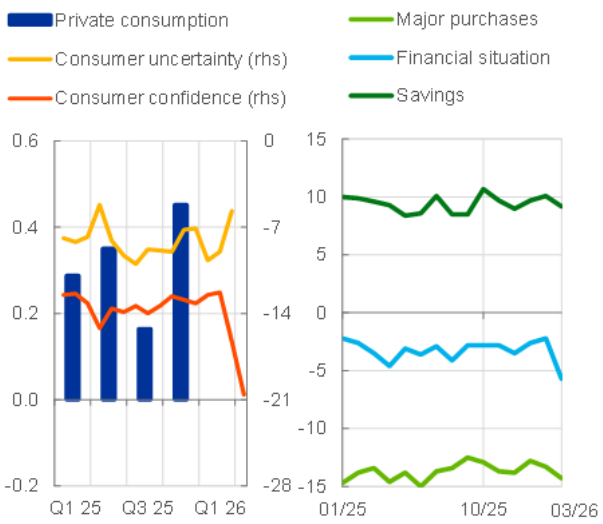
Notes: the latest observation is for April 2026.

By pushing up consumer prices and exacerbating uncertainty, the shock is likely to reduce real incomes and hurt domestic demand, which had been the motor engine for the euro area economy in recent quarters.[8] Indeed, surveys point to a significant hit to economic sentiment (Chart 5). In particular, consumer confidence has dropped sharply, which will dampen consumption.[9] And the empirical evidence suggests that the shock will weigh on business investment, with European firms significantly cutting capital and R&D expenditure in the wake of an oil shock, unlike their US counterparts.

Chart 5
Economic sentiment

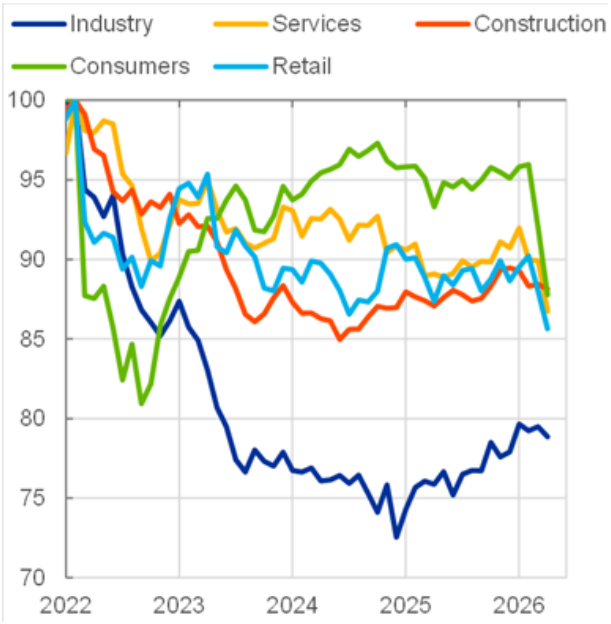
a) Household confidence and expectations

(quarter-on-quarter percentage-changes, percentage balances)



b) Confidence across sectors

(percentage balances; index: February 2022 = 100)



Sources: Eurostat, DG-ECFIN and ECB staff calculations (panel a); European Commission, Eurostat and ECB (panel b).

Notes: the latest observation is for April 2026 (panel a); savings expectations refer to the qualitative European Commission consumer survey question: “Over the next 12 months, how likely is it that you save any money?”. The latest observations are for the fourth quarter of 2025 for private consumption, April 2026 for consumer confidence and March 2026 for all other indicators (panel b).

In addition, the energy shock is also a terms-of-trade shock, further increasing the prices of euro area imports relative to exports, thus weighing on net exports.

Meanwhile, the impact on economic activity could be compounded by the endogenous tightening of financing conditions, as banks become increasingly concerned about the economic risks facing their customers. Credit standards for loans to firms have already tightened in the first quarter, according to our latest bank lending survey.[10] This warrants close monitoring, especially as banks anticipate further tightening, which is expected to accelerate in the next quarter.

On the other hand, the shock could be cushioned somewhat by households' solid financial position, a still resilient labour market and government spending on defence and infrastructure. These factors, alongside business investment in new digital technologies, have underpinned domestic demand in recent quarters.

Fiscal measures could also provide support, though they should remain temporary, tailored and targeted at the most exposed households and sectors. Otherwise, concerns about the cost to public finances and their sustainability could lead to an increase in long-term yields that would immediately weigh on private investment.

So far, the impact on economic activity has been felt through energy prices, confidence effects and financing conditions. However, Europe could start running out of jet fuel and kerosene reserves by the end of May,[11] potentially leading to material restrictions on the activity of several industries akin to those seen during the COVID-19 pandemic.

The medium-term outlook: working with scenarios

The magnitude of the macroeconomic effects will depend on the intensity, duration and propagation of the shock. To assess these effects, the Eurosystem has turned to economic scenarios. They provide us with a reference point to assess ongoing developments in a highly uncertain and volatile environment.

Under the baseline scenario in our March staff projections, higher energy prices are likely to keep inflation well above 2 per cent in the near term. Although recent inflation has been in line with these projections, there are clear upside risks in view of the latest oil price developments.

There are also clear downside risks to growth, which already came out below our projections in the first quarter of the year, at 0.1% quarter-on-quarter. For instance, the drag from the ongoing shock could further intensify if shipping disruptions were to cause input shortages, forcing euro area firms to curtail their output.

The adverse and severe scenarios we outlined in March seek to capture the risks to the inflation and growth outlook.[12] This approach has since been followed by other institutions, such as the IMF.[13]

Our projection's adverse scenario assumes a much sharper increase in energy prices, with oil and gas prices peaking at USD 119 per barrel and €87 per MWh, respectively, in the second quarter of 2026. It also incorporates stronger indirect and second-round effects, as well as greater uncertainty and heightened adverse international spillovers, such as lower foreign demand. In such a scenario, inflation is cumulatively 1.5 percentage point higher until 2028 than what we projected last December, while growth is cumulatively 0.8 percentage point lower.

Compared with the adverse scenario, the severe scenario assumes an even stronger and more persistent energy price shock, with oil prices peaking at USD 145 per barrel and gas prices at €106 per MWh in the second quarter of 2026, before declining at a much slower pace. It also envisages greater uncertainty and even stronger indirect and second-round effects. In such a scenario, inflation is cumulatively 6.3 percentage point higher until 2028 than what we projected last December.

The significant difference between the adverse scenario and the severe scenario highlights the importance of the intensity, duration and propagation of the shock as we seek to assess its impact on the inflation

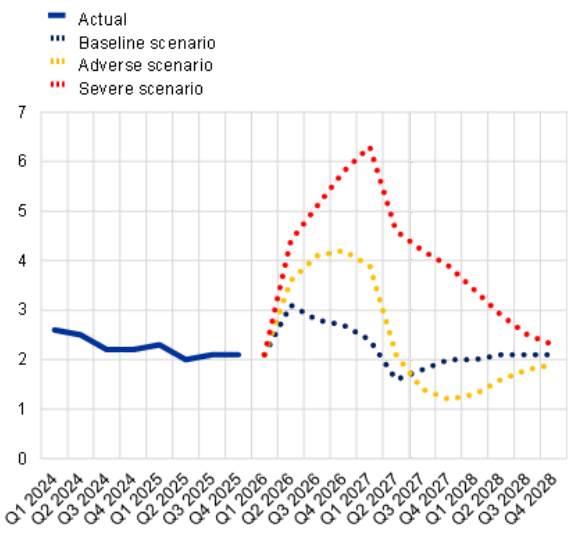
outlook (Chart 6). We will update these scenarios in our June projections.

Chart 6

Inflation and real GDP growth projection scenarios for the euro area

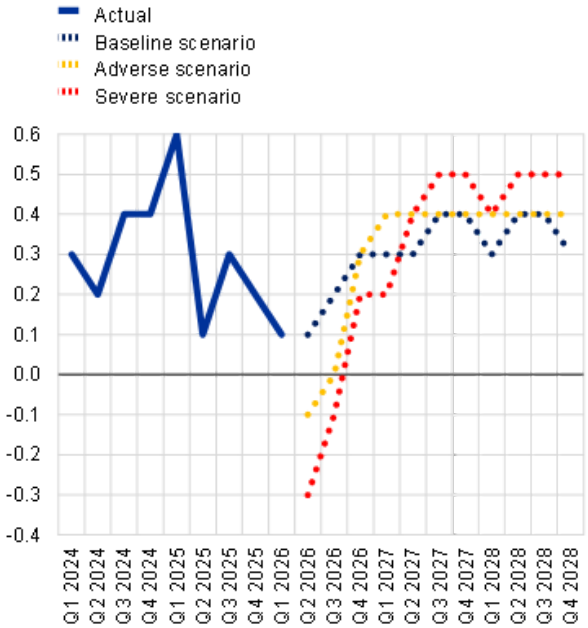
a) Headline inflation

(annual percentage changes in the Harmonised Index of Consumer Prices Index)



b) Real GDP growth

(quarter-on-quarter percentage changes in real GDP)



Sources: Eurostat and ECB (2026), ECB staff macroeconomic projections for the euro area, March.

Policy implications

The role of monetary policy: preserving price stability in the medium term

This approach in turn helps inform our monetary policy decisions.

Last week we decided to keep our policy rates on hold. Our starting position allows us to gather more information on the intensity and likely duration of the shock. Inflation was back to our 2% medium-term target, supporting the credibility of our monetary policy. Economic growth was close to potential and our policy rates were within the estimated neutral range where they neither stimulate nor put a break on the economy. These are important differences compared with the situation we initially faced at the start of the

2022 energy shock. And today we are not facing a positive demand shock similar to the one that occurred when the economy reopened after the pandemic.

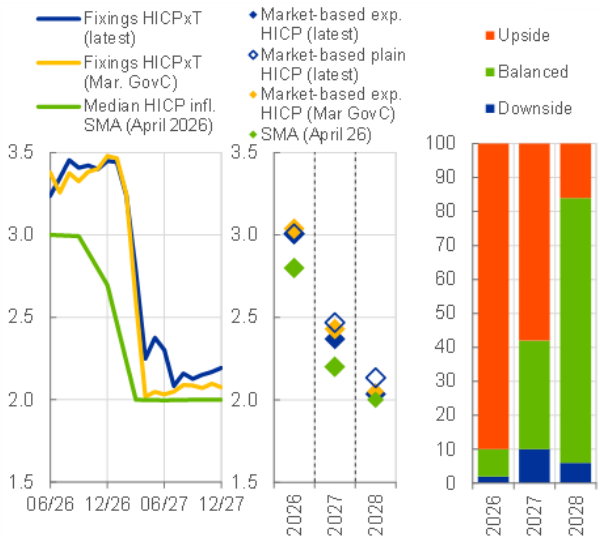
At the same time, memories of the previous energy shock are still fresh, and could lead to a faster adjustment in inflation expectations. Short-term inflation expectations, non-labour input costs and firms' selling price expectations have indeed moved higher. At the same time, medium-term inflation expectations have so far remained well anchored (Chart 7) and measures of underlying inflation remain close to our target.

Chart 7

Inflation expectations and firms' expectations for selling prices, wages and input costs

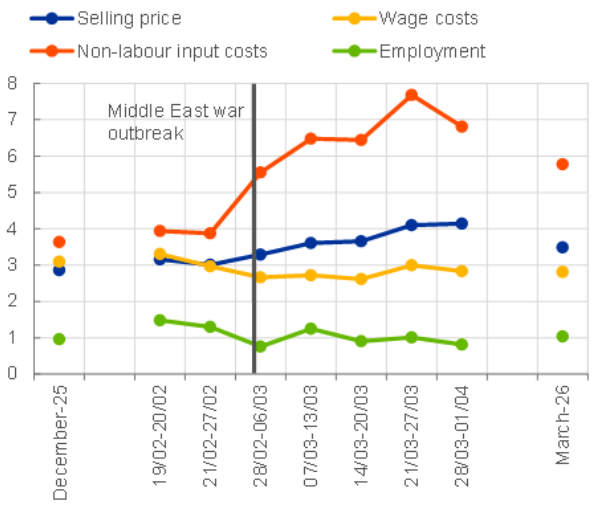
a) Market and survey-based projected inflation path and balance of risk

(year-on-year percentage changes, percentages of SMA respondents)



b) Firms' expectations for selling prices, wages and input costs

(percentage changes over the next 12 months)



Sources: Bloomberg, LSEG, SMA and ECB calculations (panel a); Survey on the Access to Finance of Enterprises (SAFE) (panel b).

Notes: in panel a, the chart displays monthly inflation paths from inflation-fixing contracts (HICPxT) and SMA results. Calendar year forecasts from the average inflation expectation components from three term structure models: 1) JSZ; 2) JSZ with bias-correction (see Burban et. al (2021) for both); and 3) Grønlund, Jørgensen and Schupp (2024). Market-based HICP forecasts are obtained adding a wedge which reflects a mechanical update of tobacco price, extended with its historical average month-on-month rate beyond the NIPE horizon. The latest market-based observations are for 24 April 2026. In panel b, the chart shows survey-weighted average expectations one year ahead before and after the outbreak of the Middle East war. Survey results over the first quarter of 2026 collection period are aggregated weekly. "December-25" and "March-26" refer to overall averages for the fourth quarter of 2025 and the first quarter of 2026 survey waves respectively. The vertical line refers to 28 February 2026. The latest observations are for March 2026.

We are nevertheless paying attention to possible signs of a de-anchoring of medium to long-term inflation expectations. In particular, we will be looking at the indirect pass-through of higher energy costs to the broader consumption basket prices and possible second-round effects.

A key consideration will be the pricing power of firms. A weaker economy, where the supply shock triggers a negative demand shock, would reduce this pricing power. A more resilient economy may instead leave more room for price increases. The latest PMI surveys point to a contraction of activity in services. While manufacturing has so far been more resilient, this partly reflects a buildup of safety stocks in response to supply chain disruptions.

Regarding wages, we will be closely monitoring their development, but wage-setting typically lags behind price-setting. At this stage our wage tracker continues to point to wage moderation amid a cooling labour market. After the previous energy shock, we actually saw a significant contraction in real incomes, resulting in an initial reduction of the labour share of income and the relative price of labour.[14] In today's environment, the adoption of artificial intelligence (AI) could further weigh on the labour share, primarily through wage compression.[15] For example, in Italy 42% of workers fear that they could be replaced by AI.[16]

Overall, the current situation seems to be drifting away from our March baseline projections, which increases the likelihood that we may need to adjust our policy rates.

Increasing Europe's resilience to energy shocks

Faced with an energy shock, monetary policy can anchor expectations and ensure the return of inflation to target over the medium term, while fiscal policy can smoothen the hit to economic activity. But they involve costs no matter how smartly and carefully engineered they may be. These costs cannot be ignored on the grounds of their low frequency. On the contrary, they are amplified by the fact that supply shocks are becoming more frequent owing to the use of critical inputs as leverage in the geostrategic power struggle.

In response, Europe needs to increase its resilience to energy shocks. This requires further reducing our dependence on fossil fuel, which still represents more than half of the EU's overall energy mix (Chart 8, panel a).

A more sustainable energy mix would benefit price stability. It would support disposable income for European households. And it would reduce the energy bill for European firms, sustaining not just traditional energy-intensive sectors but also new ones, such as data analytics, AI and data centres that are currently the source of growth in other economies. At the same time, a more sustainable energy mix would contribute to the common good of combatting global warming by abating CO2 emissions.[17]

Europe is already less exposed than it was in 2022 thanks to the rapid advance of renewables. As of 2024, more than two-thirds of EU electricity generation comes from low carbon sources, which is much more than in the United States and China. Renewables is the largest contributing source at 48%, with nuclear energy accounting for another 23%.[18]

From 2015 to 2025, the EU's energy intensity – that is, energy expenditure as a share of GDP –declined by 32% and now stands below that of Asian economies (Chart 8, panel b). Energy consumption is 10% lower than in 2021, and gas import volumes have fallen by 20%.[19] While this partly reflects the impact of higher

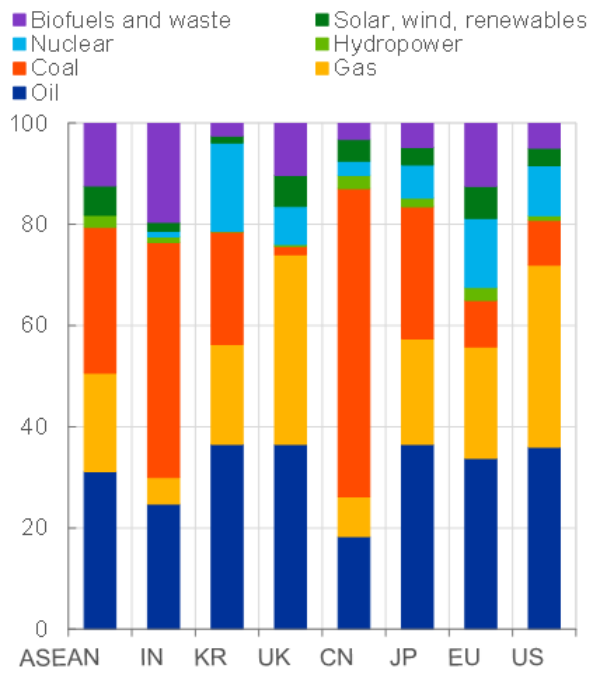
energy costs on the European manufacturing sector, it is also the result of efficiency gains. Overall, the IMF estimates that Europe's energy efficiency gains and cleaner energy mix over the past five years have reduced the cost of the current shock by 12% for households at current prices.[20]

Chart 8

Energy mix and energy intensity

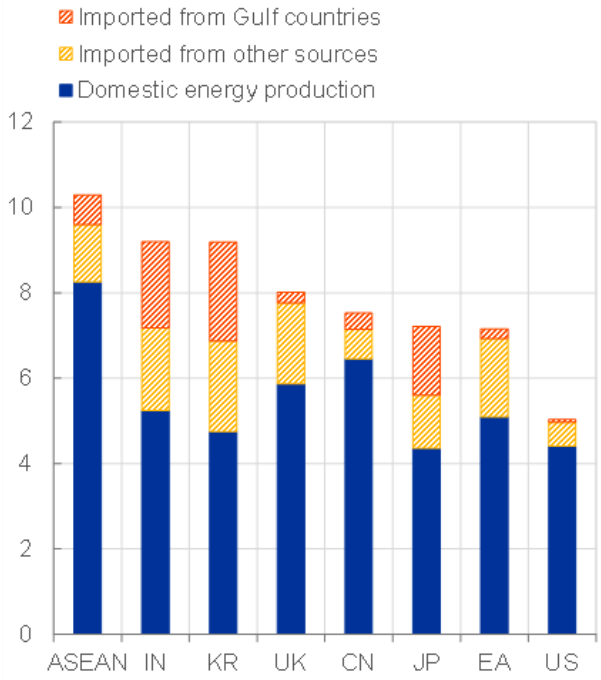
a) Energy mix across selected countries

(percentage)



b) Energy intensity of output

(energy expenditure, as percentage of GDP)



Sources: International Energy Agency (panel a); Organisation for Economic Co-operation and Development, Inter-Country Input-Output tables 2025, and ECB calculations (panel b).

Notes: in panel a, total energy supply, which measures the total energy available in an economy, is calculated as domestic production plus imports minus exports, international bunkers and stock changes. It differs from final energy consumption, which measures energy delivered to end users. The latest observation is for 2023 for China, India and ASEAN, and for 2024 for the rest; in panel b, output covers all sectors of the economy, including services. Energy intensity is computed as expenditure on energy goods (crude oil, refined petroleum and gas) by all sectors in an economy, divided by total output.

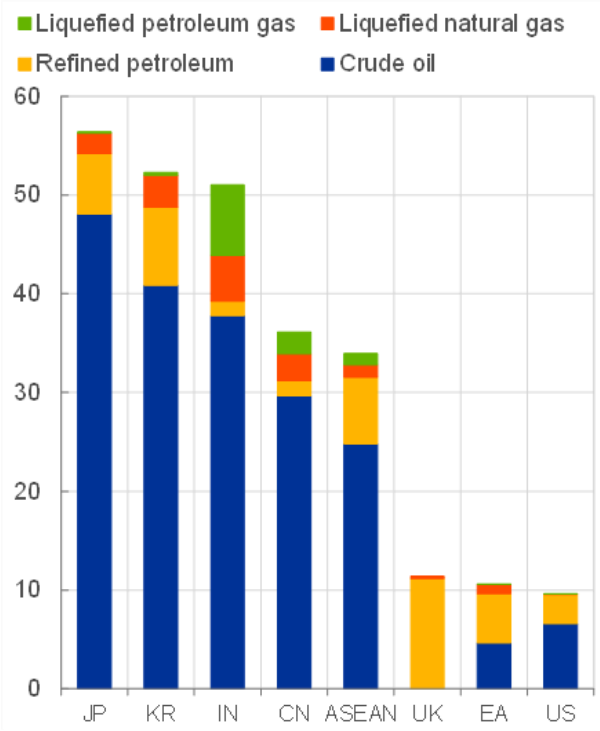
In particular, Europe has become less dependent on energy imports from Gulf countries and is now significantly less exposed than Asian countries (Chart 9, panel a). This implies that output at risk from the current disruptions is lower than in Asia but still higher than in the United States, which has become a net petroleum exporter. This is illustrated by a fragmentation scenario in global commodity markets, in which supply shortages propagate through the global production network and create broad-based production constraints (Chart 9, panel b).

Chart 9

Energy imports from Gulf countries and output at risk

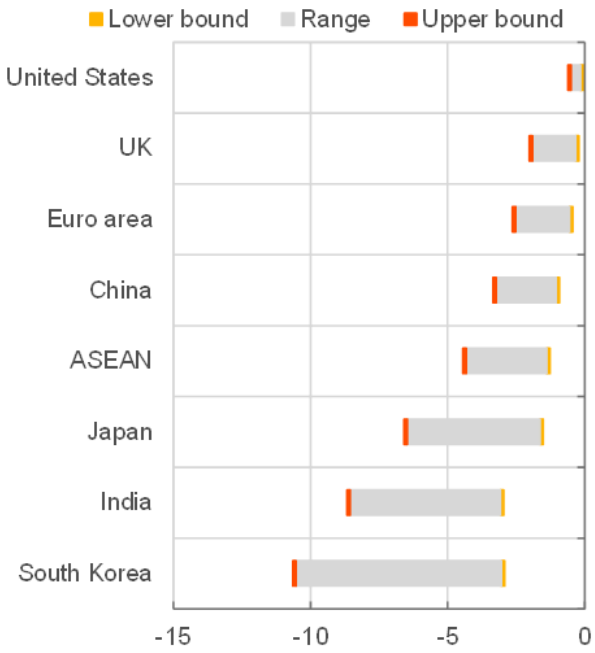
a) Energy imports from Gulf countries

(percentage of total energy imports)



b) Output at risk

(percentage deviation from steady state)



Sources: TDM and ECB staff calculations (panel a); OECD TiVA, Baqaee and Farhi (2024) and Attinasi et al. (2023) (panel b).

Notes: Gulf countries include Saudi Arabia, United Arab Emirates, Qatar, Kuwait, Iraq and Iran (panel a); non-linear impact simulated through 25 iterations of the log-linearised model. Upper range output effects are computed based on a calibration of the model with lower substitution elasticities from Boehm et al. (2023)The Long and Short (Run) of Trade Elasticities, "", American Economic Review, Vol. 113, No 4, April; and lower range output effects are based on a calibration with higher substitution elasticities from Fontagné et al. (2022), "A new dataset on product-level trade elasticities", Data in Brief, Vol, 45, December (panel b).

However, the current shock shows that further efforts are needed to increase Europe's energy security and resilience to further shocks. According to the President of the European Commission, the EU has spent an extra €27 billion on fossil fuel imports since the war in Iran started.[21]

Looking ahead, Europe needs to stay the course on the energy transition and further integrate its energy market.[22] In particular, interconnecting energy grids and coordinating the energy supply would help it reduce the risks stemming from the local volatility of renewable energy sources, which are available at different times across the euro area. It would also make it possible to leverage the diversity of energy mixes across Member States.

The European Grids Package is an important step in this direction. But if we want to establish a single market for energy and overcome the intrinsic difficulties of transporting electricity – by increasing storage capacity, for instance – then we need to be more ambitious. Given the investments required for this and the potential common benefits – as documented in the Draghi report[23] – there is a case for jointly financing at least a portion of them.[24]

There could be a silver lining for the European economy. If energy shocks push us to innovate and do more with less fossil fuel energy, not only will price stability benefit but productivity growth will increase.

Europe already plays a leading role in sustainable finance. Green bonds are seeing the fastest growth in international euro-denominated bond issuance, and the euro has surpassed the US dollar in international green and sustainable bonds. Looking ahead, Europe could position itself at the forefront of financial instruments designed to hedge against sustainability-related risks.[25]

Conclusion

Let me conclude.

The war in the Middle East has led to a sharp increase in energy prices, pushing up inflation and weighing on economic sentiment.

The implications of the war for medium-term inflation and economic activity will depend on the intensity, duration and propagation of the energy price shock.

We are using scenarios to assess these implications, even as uncertainty continues to cloud future geopolitical developments. These scenarios allow us to use informed judgement as we assess incoming information and decide on the appropriate monetary policy reaction.

However, the monetary and fiscal responses to energy supply side shocks are costly no matter how smartly and carefully engineered they may be. Other tools are needed, as one thing is certain: sustainability contributes to stability. To be more resilient to energy shocks, we need to stay the course for the energy transition in the name of price stability and economic prosperity.

Thank you for your attention.

Annexes

6 May 2026

Slides by Piero Cipollone, Member of the Executive Board of the ECB, at the 2026 Sustainable Development Festival in Milan

1.

See also Panetta, F. (2022), "Greener and cheaper: could the transition away from fossil fuels generate a divine coincidence?", speech at the Italian Banking Association, Rome, 16 November.

2.

Between February 2024 and February 2026, annual inflation averaged 2.1% in the euro area, close to our 2% inflation target. And between the last quarter of 2023 and the last quarter of 2025, annual growth averaged 1.3%, close to potential growth estimates.

3.

Lagarde, C. (2025), "Trade wars and central banks: lessons from 2025", keynote speech at the Bank of Finland's 4th International Monetary Policy Conference, Helsinki, 30 September.

4.

See Lagarde, C. (2025), "Strategy assessment: lessons learned", introductory speech at the opening reception of the ECB Forum on Central Banking 2025 "Adapting to change: macroeconomic shifts and policy responses", Sintra, 30 June 2025; and Ciccarelli, M., Darracq Pariès, M., Landau, B. and Sousa, J. (2025), "Exploring an uncertain future with the help of scenarios", *The ECB Blog*, 15 January.

5.

ECB (2026), *Monetary Policy Statement*, 19 March.

6.

Birol, F. (2026), *Interview with Le Figaro*, 6 April (in French only).

7.

These estimates are based on oil flows typically passing through the Strait of Hormuz, adjusted for tankers still passing through the Strait, the rerouting of exports via pipeline infrastructure and the release of strategic reserves, as at 14 April 2026.

8.

Coibion, O., Georgarakos, D., Gorodnichenko, Y., Kenny, G. and Weber, M. (2024), "The Effect of Macroeconomic Uncertainty on Household Spending", *American Economic Review*, Vol. 114, No 3, pp. 645–77.

9.

Anaya Longaric, P. et al. (2025), "Oil Shocks and Firm Investment on the Two Sides of the Atlantic", *Working Paper Series*, No 3116, ECB, 22 September.

10.

ECB (2026), "April 2026 euro area bank lending survey", *press release*, April.

11.

In mid-April, the Head of the International Energy Agency said that Europe had "maybe six weeks or so" of remaining jet fuel supplies. On 30 April, the European Commission stated that, while there are no fuel shortages in the EU at present, the EU should start preparing for possible consequences if the situation continues beyond the end of May.

12.

ECB (2026), *ECB staff macroeconomic projections for the euro area*, March.

13.

IMF (2026), "Global Economy in the Shadow of War", *World Economic Outlook*, April.

14.

Cipollone, P. (2024), "The confidence to act: monetary policy and the role of wages during the disinflation process", speech at an event organised by the House of the Euro and the Centre for European Reform, Brussels, 27 March.

15.

Minniti, A., Prettner, K. and Venturini, F. (2025), "AI innovation and the labor share in European regions", *European Economic Review,* No 177, 16 May.

16.

See the 30 April 2026 Agipress article (in Italian only), "IA e lavoro, cresce il timore di essere rimpiazzati: il 42% degli occupati si sente sostituibile".

17.

Elderson, F. (2026), "Europe's fossil fuel dependence poses risks to price stability", *The ECB Blog*, 7 April.

18.

Eurostat (2026), *Energy in Europe – 2026 edition*.

19.

IMF (2026), *Regional Economic Outlook for Europe*, April.

20.

Celasun, O. (2026), "The 2026 energy shock: how to deliver targeted and temporary support while encouraging energy conservation", speech at the Eurogroup meeting, Brussels, 4 May.

21.

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This includes climate-related risks, for instance. Recent studies propose issuing performance-linked bonds, such as catastrophe bonds, sustainability-linked bonds or climate-linked bonds, to mitigate physical and transition risks. These bonds adjust payouts based on climate-related metrics, functioning similarly to inflation-linked bonds but tied to climate variables. See ECB/EIOPA (2023), "Policy options to reduce the climate insurance protection gap", *Discussion Paper*, April, and Broeders, D., Dimitrov, D. and Verhoeven, N. (2024), "Climate-linked bonds", *Working Paper Series*, No 3011, ECB.

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